Pittenger & Anderson, Inc.
REGISTERED INVESTMENT ADVISOR

P&A's Quarterly Letter

Q1 – April 12, 2018

The Speed of Trust

Dear Friends and Clients,

In January of this year, we sent all clients with email addresses on file, a satisfaction survey. The project was conducted by the P&A "next gens"….everyone but Dan and I. We, of course, watched with great interest. The survey questions were engaging and well thought out, they focused on the use of technology, favored forms of communication, financial planning, what have we done for you lately….lots of different subjects. Our younger partners complied and quantified the results, then replied to the clients that gave up their names. The next step was to contemplate how best to modify our behavior in order to take advantage of learning our clients preferences.

Having grown up in the performance gene pool of this business, I expect to solve most client problems by reverting to the financial blocking and tackling skills required to manage a portfolio. You know, if you're good with a hammer….everything starts looking like a nail. Guess what? No hammers, no nails and no performance issues….150 participants had opportunities for remarks and no one wanted to talk about the "Xs" and "0's." Instead, clients wanted to wax philosophically about their ability to sleep through the night, access a listening post and plan for the future…..these are the things that are important to them. A high percentage of these respondents used the word "trust."

So….. I have a friend/client of long standing (48 years) who always wants to trade business notes at year-end. How did you guys do? Was it as good as last year? Where will your growth come from? He has been a client of P&A from the beginning. In December, he asked me the size of our assets under management…..$1.5 Billion was the reply. There was a long pause and then he said, "That's a lot of trust." His clairvoyance staggered me a bit, "You're right….that's a lot of trust."

Long Term Trust….

During my tenure at Dean Witter, most of the accounts I covered were institutional. Many thought remarks like "Good Morning, how are you? And thank you" were signs of weakness. The competition had names like Goldman Sachs, Chase Manhattan, Solomon Brothers, Bear Stearns…..lots of heavy weights. All of these guys were top tier underwriters and Dean Witter was not. My previous employer was a local bank, not top tier either. That meant I grew up in the business selling from an empty wagon…..virtues and disadvantages. When Dan joined me, he had a similar background. So we started every day by calling Mutual of Omaha, General Re in Kansas City, Norwest in Minneapolis, Berkshire Hathaway, Firstier, and a host of funds and investment advisors….putting our oars in the water and getting in line on general market trades.

Occasionally we caught a few "size" orders on deals where the New York desk was a selling group member. The rest of our time spent with these institutional accounts focused on pairing buyers and sellers…..true brokerage work. The institutional part of the day usually ended by 9:30 or 10:00 and focus shifted to our bread and butter country banks. By 2:00, they were old news and we were on to our retail clients…. helping them build portfolios, figuring out tax swaps and creating liquidity when necessary. The day ended around 5:30 and began again the next morning at 8:00.

After 4 or 5 years we became the most productive bond salesmen in the firm. New York and Chicago had no idea who we were covering and only cared about order flow. Sales mangers changed with great regularity and none came out to visit…..fine with us. One in particular decided to exercise his authority by taking General Re away from Dan. That didn't work out the way the New York desk had it planned. The account was re-assigned to a New York hot shot but the General Re portfolio manager kept calling Danny with orders….probably saved that New York sales manager a bloody nose. So finally one of those East Coast types showed up to see what we were doing. Apparently, hard work, consistency and listening to the client is too tough for New Yorkers to replicate….he didn't get it and we never saw that guy again.

This story has an interesting punchline. During the 1980's interest rates were measured with double digits. Our institutional clients were pretty well heeled folks and they wanted to build personal portfolios similar to the ones they managed for their employers. Our heavy weight competitors did not cater to individuals but Dean Witter did. We were happy to sell them smaller lots of the same bonds they were used to buying… at the same prices. In addition, many of them wanted to own equities, these relationships probably became the lynchpin of our stock expertise. Institutions were our meat and potatoes, but the personal accounts of these contacts became a significant percentage of our business.

Building a bond portfolio was second nature to us but I have to admit, the equities were a little more esoteric. We made friends with some of Dean Witter's mutual fund portfolio managers, bent the ears of our insurance clients (they worked with stocks more than we did) and emulated all the giants in our industry. While all this was going on we maintained the same M.O.……show up early and work late. By 1995 we had given Dean Witter all the help they needed and it was time to go our own way. We flight planned our new business to manage $75 million in assets and set out to gather them. As you can tell by now, we woefully undershot and the rest of the story has been a great ride.

I should get back to the subject at hand. We readily admit that the client trust we were able to create at P&A and predecessor banks would be very difficult for anyone to reproduce….not just the New Yorkers. I spent 5 years and Dan spent 10 working at regional bank Investment Divisions. They were far from pressure cookers and we were free to develop relationships at a very Midwestern pace. Once an army of 2 at Dean Witter, the same credentials shined brightly.   We had already learned our customer base and knew they would be loyal to us if treated with respect.   Dan and I were a steady partnership expecting hard work and ethical behavior from each other. Both of our families hailed from Boone County, Nebraska….. a place where long hours and integrity were assumed.

This might be a little thick, but there's no escaping it…..we are of the opinion that trust is a lot like love, a shared value. Don't ask for or assume either one until you've offered more than you expect to receive.   Love is an intense feeling of deep affection.   Trust is a firm belief in the reliability, truth and strength of someone or something. Together they are probably the heaviest of human emotions.   Dan and I had been unintentionally working on these concepts since 1970. That seems to us like a reasonable timeframe. If you want someone to trust you tomorrow, start working on the project 10-15 years ago.

When Trust Becomes Second Nature….

Last Sunday our minister offered an interesting sermon. It seems he encountered a highly regarded athlete.   A rock climber just back from Yosemite, and down off El Capitan, was holding court on how to develop the correct psyche for his pastime. "The suppression of fear is key to maintaining hope."

For the purposes of the sermon, our minister didn't associate this exercise with the creation of trust…..but I`m sure he won't object if I do. At any rate, it occurred to me that it must be second nature for a number of athletes to triumph over the inherent fears of their sport, not only by stifling, but by transferring the risk. Here are a few examples:

Sky Divers	Ski Jumpers	Race Car Drivers	Scuba Divers	Bobsledders
Rock Climbers	Gymnasts	Surfers	Snowboarders	Bull Riders
Mountain Bikers	BMX	Kayakers	Water Skiers	

In virtually all of these sports, the thrill of victory offsets the agony of defeat,…..is that enough? Just suppressing those fears might not be enough either. Suppressing anything would obviously be a short-term fix. The fears generated by these risks if left to their own devices will not go away. However, once identified they can be transferred. No matter how thin the deterent, the process of transferring a risk generates trust and that trust can then become front of mind for the participants. The same examples:

Sky Divers	Parachutes and Squirrel Suits	Ski Jumpers	Helmets and pads
Race Car Drivers	Belts, helmets and roll cages	Scuba Divers	Twin regulators, tanks and training
Bobsledders	Helmets and sled cages	Rock Climbers	Carabiners, bolts and ropes
Gymnasts	Spotters, mats	Surfers	helmets, PFDs and Shark repellant
Snowboarders	Helmets and vests	Bull Riders	Helmets, pads and clowns
Mountain Bikers	Helmets and Pads	BMX	Helmets and Pads
Kayakers	Helmets and PFDS	Water Skiers	Helmets and PFDs

It is common for all of us to transfer risk and create trust. A chef will do it by using brand names, mechanics favor one manufacturer over another and athletes do it by favoring coaches. Actions like these simplify our lives and speed daily decisions. People want to be happy, confident and brave. Serving Starbucks over Folgers doesn't seem like the kind of triumph that will single you out, however, pour the right coffee, offer fresh pastries and cook with the finest cheeses….pretty soon you will be known as the breakfast queen (or king). Breakfasts morph into lunches and lunches give way to dinners. In no time, friends will be asking you questions about your party secrets. Just like long term trust, the trust generated by these second nature skills spans a number of descriptions and takes time to hone….15 to 20 years is still the time frame.

The Speed of Trust

Stephen M.R. Covey authored a book called *The Speed of Trust.* I tried to read it twice and failed…it was a slog. My third and final attempt was using Audible, an Amazon listening app (which I strongly recommend)…..that failed too. I loved the title of Covey's book as well as his conclusions…..business moves faster given an environment of trust. I guess watching him get to the point was just too difficult for me. The concept here is actually pretty simple, decisions are made quicker and more accurately when trust lubricates all the moving parts. Due diligence is quicker, the facts are easier to see (transparency) and participants tend to be familiar.

So if a high dollar author with roots in self-help disciplines has a tough time explaining trust why should we tackle it? Because of its importance in forming relationships, transferring expertise and lubricating the gears of business. It is our opinion that trust is a shared ingredient, and its speed is amplified when it is generated by all problem solving participants. For the most part, people want to trust each other and once approached constructively seem to have a fair amount of patience. Our trusted relationships are badges of honor and a source of personal pride. Knowing we have the ability to "make things happen," allows a person stand out in a crowd. It might be a high-level decision or the timely reboot of cellphone, regardless, it is an opportunity to display expertise augmented by a trust that has not yet been earned by your peers.

Improving the Environment of Trust….

Now comes the obvious questions. What happens when trust is unrequited? How does one guard against embracing charlatans, shysters and thieves? Let's assume that you use an equal amount of due diligence in all relationship decisions and have a process in hand. If you're like us, you identify the problem, define goals, brainstorm solutions, assess alternatives, chose the best one, execute and then follow up. This is the 7 step decision making process. If you have a process like this at hand, don't discard it, add to it. If you don't……we suggest you develop one. Here are our 3 recommended add tos. They are habits we see being used by our most successful clients.

Ask for and Use Referrals. Pay attention here, we are not asking you FOR referrals, we are encouraging you to cultivate your resources by ASKING OTHERS for a referral. Business and professional peers, whether you know them or not, will be flattered when you ask them for an opinion. I pay attention to my wife's circle of friends and well as those developed by my children. They represent resources once removed from me and hopefully void of bias.

My dad was a very popular figure in his day with only a moderately good memory for names. When greeted warmly by someone he didn't know, I could always tell. When the situation allowed I would ask
"Dad, what's that guy's name and what does he do?"
"He's a rancher. I don't remember his name right now but someday I will be glad I know him."
Dad was friendly to everyone and it paid big dividends over time. Like any of us, his memory would come and go. When his mind drew a clear focus on the guy's name, he would write it down and then transfer it to a notebook designed for that purpose. He might never get back to that fellow but when he needed the connection it was there.

Once again, referrals and the following two skills are designed to augment an organized decision making process. If you take the time to use a 7-step method you will learn to trust the process. If you use referals to further validate those decisions you will add a modicum of trust. My preference is to use multiple referrals.

Constant use of the sixth sense. Sight, smell, hearing, touch and taste are the five traditionally recognized methods of perception. We also have a "sixth sense", it is called Extra Sensory Perception or ESP by parapsychologists. Common folk refer to it as "trusting your gut." I have learned over the years that people tend to have a well-developed sixth sense when dealing with money, children and their loved ones.

Continual application of the sixth sense helps reveal the potholes in relationships that we all want to avoid. It will display the difference between honest mistakes and larceny, sincerity and subterfuge, promises and divorce. Any relationship we have can improve or go south. Staying in touch with your sixth sense is a distance early warning system that will help reveal changes.

Collaboration….."To work jointly with others in an intellectual endeavor." P&A's best relationships are highly collaborative, when both client and advisor are engaged, good things happen. When client, spouse and advisor are engaged, even better things happen. We want to like our clients and we want our clients to like us. A transparent relationship requires both sides to focus on established goals and objectives. The presence of consistency, integrity and discipline will show up quickly. Collaboration also allows the client to employ the opinion of multiple trusted advisors. We have always recommended the advantages of a three-headed team…..accountant, attorney and investment advisor. Some of these people charge by the hour, some are fee only and most will work gratis on simple projects that need another set of eyes. Collaboration is cheap. Clients who ask for advice from multiple advisors make it clear that they value a team effort. When things get tough…..you find out who you can trust and why.

The World According to Pitt and Dan….

Some of our newer clients have accused us of being perma-bulls. Although that has been true for the last 9 years, it hasn't been the case for the last 23. We're glad for the success we have delivered and happy we haven't blinked since the spring of 2009. Nonetheless, we put a lot of thought into our market calls and are constantly tinkering with our portfolio strategies. In our last couple letters we spent some ink discussing our exposure to high conviction stocks, complimented by diversifying into large, mid and small cap ETFs. We won't continue to beat that drum in this letter but we are happy for the success that strategy has generated. Read on for our current market call.

What Would You Do?

In January of 1998 my attention was drawn to a stock that I had owned in the early '80's. I made a little money with it but decided the company had some growing up to do and sold it…. the stock went on my watch list. In the late '90's a friend of mine called my attention to the company again and I decided to buy it. However, I broke one of my cardinal rules…..I convinced myself the stock would go down before it went up and I waited for a lower price.. The $20 opportunity I had in January turned into a $33 opportunity in June. The stock continued to trade higher and, never looking back, I began to accumulate it for clients. The investment was an unbridled success and here's a thumbnail sketch of what the stock has done since:

June 30, 1999	$ 1.65 per share adjusted for the following splits:
June 2, 2000	2 for 1 split
Feb 25, 2005	2 for 1 split
July 24, 2012	Company begins to pay regular dividends
June 2, 2014	7 for 1 split
Mar 23,2018	$ 169.06 per share

A pretty meteoric rise eh? Fast forward from 1999 to 2018 and imagine yourself with a $10 million position in this stock. During this holding period you have lived through the millennium, the dot com bubble, the crash and recession of 2009, a correction in 2011 and a 26,000 Dow in 2018. What do you do?

We like this company as much today as we did in 1999, but we have been trimming our holdings back to position size since the early 2000's. Guess you might say it's how we roll. This is a tech stock and by definition a growth stock. When you get one of these right, it can be a great ride. However, our scars are real and we have learned not to expect buying at a low nor selling at the high. Instead, we attempt to identify stocks like this and hold them long term, or at least as long as they continue to grow. To that end, we find ourselves systematically trimming winners back to position size while continuing our research efforts in hopes of finding similar opportunities.

So what does P&A do with a $10 million position like this? Nothing, we've been doing our job all along . This trim and hold system has worked well for over 20 years. We always regret selling winners and we do, from time to time, sell an entire positions. Those regrets are small and the cash we generate gives us the opportunity to diversify into the new ideas generated by our research efforts. The whole process is an infinity loop and one of the many backbones of our business plan.

What are the Chances of Finding More Winners?

Believe it or not, they are surprisingly good. Regulators don't like us cherry picking success stories from our past, so we can't name names. However, if you want to discuss the example above or potential candidates to replace it, give us a call we love to talk shop. Truth be known, finding these companies is probably easier than buying them. Most have outperformed for an extended period and sport earnings metrics far higher than their peer groups. Not surprising that we should have to pay more current dollars in order to buy a superior stream of future income. It is much easier to buy stocks like these when monies are being generated by winning positions….kind of adds to a portfolio manager's courage. Being in a position to own stocks like this is a by-product of our trim and hold system…..or perhaps our trim and hold system is a by-product of owning stocks like these? Who knows?

We Like Equities

It would be a disappointment to some if we failed to make the transition from "Really Like" to "Like." Our first fear is the Fed. Using the Federal Reserve Act of 1913, the U.S. Congress established three key objectives for monetary policy: maximizing employment, stabilizing prices and moderating long-term interest rates. The first two are generally referred to as the Federal Reserve's dual mandate. The Fed's tenacity in pursuing this charge has created a portfolio manager's often observed admonition, "Don't fight the Fed."

Eventually the market will understand that it is dealing with demand pull inflation as opposed the cost push inflation generated by the oil crisis of the 1970's. Demand pull inflation usually occurs when gross domestic product increases and unemployment falls, rarely a harbinger to economic recession. Our equity markets have been stimulated by the central bank's quantitative easing for almost 10 years now, and eventually all good things must end. The Consumer Price Index hovered in the low 1.0% range from 2010 – 2016. In 2017, it expanded to 2.5%...inflation has been creeping back into prices. The Fed has engineered five rate hikes since December of 2015, including a 0.25% increase in March of this year. Three more rate hikes are forecast for 2018…..the stock market did not like the last one.

We continually read that the market has not had a correction for nine years. We disagree, the price action witnessed in late 2010 - 2011 fulfilled all of our -16% requirements for a market "breather." P&A didn't rest during that one, we gutted it out while the Dow yo-yoed from 12,810 to 10,655 and back again. It wasn't much fun but nobody got bucked off and we all lived through it. The observant readers of our recent letters may have picked up on our transition from abundant equity positions to a concentration of high conviction stocks combined with diversified ETFs. This trend will continue.

We won't be sacrificing highly appreciated positions in any of our before or after tax accounts just to create cash. We will, instead, continue to systematically harvest gains and reinvest the proceeds in lest volatile holdings. Market up or market down, it is our goal to increase performance by modest amounts, complimenting the already hard work being done by the averages. Cash might be our friend as we work through these situations so prepare to be patient. When all is said and done we consider these events to be business as usual and the crosscurrents of a market that continually moves stocks from weak hands into strong hands.

The days are getting longer and the nights are getting shorter. Oil up you fishing reels, knock last year's mud off those golf clubs and invite your significant other out for a warm night of patio dining. Summer will be here before you know it. I challenge all of you to have more fun than Dan and I do….that ought to keep everyone busy

On behalf of the P&A team,

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